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Finanční analýza společnosti Yum!

Financial Analysis of Yum! Company

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1. Introduction
2. Description of the financial analysis methodology
3. The Yum! company overview
4. Financial analysis of Yum! company
5. Conclusion

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The declaration

"Herewith I declare that I elaborated the entire thesis, including all annexes, independently."

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Contents

1 Introduction

The thesis is focused on financial analysis of Yum! Company. Yum! Company is a United States-based Fortune 500 corporation. The company is based in Louisville, Kentucky, is the world's largest restaurant company in terms of system restaurants, with more than 35,000 restaurants in more than 110 countries and territories. KFC, Long John Silver's, Pizza Hut and Taco Bell are parts of its restaurant brands.

The objective of this thesis is to analyze the operating activities of Yum! Company and evaluate the company. And in the process of analysis, the thesis will use different financial analysis methods such as common-size analysis and financial ratio analysis. It is possible to analyze financial statement of the company and know its operating activities.

There are five parts in this thesis. The first part is introduction; it will show you some basic information about the company. The second part is description of methodology of financial analysis, in this part, some basic methods' definition will be given and their usages will be introduced clearly. And most of these ratios will be used in the analysis part. This chapter provides a theoretical background of the analyzing part. Only to know the methods, we can analyze some ratios which affect the company. The third part describes the situation of Yum! Company. The current situation of the company will be introduced and it will be compared with its competitors. Their weakness, strength, and opportunities will be mentioned too. The fourth part is the financial analysis of Yum! Company, it's the most important part in the thesis. Some methods also will be used to analysis this company which are introduced in the second part. I compare the financial statement of the company from 2007 to 2011. The last part is conclusion, some summary and conclusion will be given in this part.

2 Description of the financial analysis methodology

The basic methods are introduced in this chapter for analyzing the company. The methods help us to calculate some financial ratios and we can analyze better and precisely. These methods are necessary to proceed to analyze financial health of a company. Only to know these method, we can understand better how to proceed financial analysis. Firstly, common size analysis will be explained, then financial analysis will be the next and DuPont analysis will be the last one. The main sources of this part is the book by Henry, Greuning, Broihahn and Robinson (2008) and Brealey, Myers and Allen (2008).

2.1 Common size analysis

The common size analysis is a method of static analysis. It is a restatement of financial statements data and their changes will be presented over the time. And it is a method that compare financial statements of different-sized companies or financial statements of one company from different time periods. Through these comparisons, we can analyze some part of one company's financial operations against the totality of the operations. And then we can identify the trends and major differences.

There are two types of common size analysis, one is **vertical common-size analysis,** the other one is **horizontal common-size analysis**. These types of analysis help a financial statement reader compare the companies of different sizes, which can be difficult to do when the dollar amounts vary significantly, and evaluate the performance of a company over time.

2.1.1 Vertical common-size analysis

When vertical common-size analysis is used, each item is state as a percentage of some total which contains that item. The method allows one to see the composition of each of the financial statements and determine if significant changes have occurred. Some key financial changes and trends can be highlighted. It focuses on comparing each item from financial statement with the overall and then analyze the importance and influence of the item in the overall. Vertical common-size analysis is used more common than horizontal common-size analysis.

2.1.2 Horizontal common-size analysis

In horizontal common-size analysis, a given year is chosen as the benchmark then other years are compared with the benchmark. It is focused on trends and changes in financial statement items over time. Through this method we can see the relative changes over time and estimate whether it is a good trend.

A useful way to analyze financial statements is to perform either a horizontal analysis or a vertical analysis of the statements. These types help us to evaluate the performance of a company over time.

2.2 Financial ratio analysis

Financial ratio analysis is the calculation and comparison of ratios which are derived from the information in a company's financial statements. It is the key of financial analysis. The level and historical trends of these ratios can be used to make inferences about a company's financial condition, its operations and attractiveness as an investment. Financial ratios are calculated from one or more pieces of information from a company's financial statements. In isolation, a financial ratio is a useless piece of information. In context, however, a financial ratio can give a financial analyst an excellent picture of a company's situation and the trends that are developing.

Financial ratio analysis put the ratios into categories which tell us about different aspects of a company's finances and operations. Five ratios will be introduced in this chapter:

- **Financial leverage ratios;**
- **Liquidity ratios;**
- **Activity ratios;**
- **Profitability ratios;**
- **Market ratios.**

2.2.1 Financial leverage ratios

Companies can finance their assets in two ways. One is financing with debt, the other is with equity. Financing with debt will take more risk because the company will pay interest and will have to repay the principal as promised. The company financing with equity will not have the obligation to pay interest. Instead dividend will be paid to the shareholders but it depends on the dividend policy of company. And some companies choose to finance with both equity and debt. But how a company make their choices is related to the risk they bear.

Financial leverage ratios are used to solve this problem. It will help the company to assess how much financial risk the company has taken on. There are two types of financial leverage ratios: component percentages and coverage ratio.

Component-percentage financial leverage ratios

1) The total debt to assets ratio indicates the percentage of the total debt in the total assets. If the ratio is higher, it indicates the company has high risk because the debt and interest has to pay back in a specified period.

$$\text{Debt to assets ratio} = \frac{\text{Total debt}}{\text{Total assets}} \tag{2.1}$$

2) The long-term debt to assets ratio indicates the percentage of long term debt in the total assets. From this ratio, we can see the proportion of a company's assets financed with long term loans.

$$\text{Long term debt to assets ratio} = \frac{\text{Long term debt}}{\text{Total assets}} \tag{2.2}$$

3) The debt to equity ratio indicates the relative uses of debt and equity as sources of capital to finance the company's assets. The two components are often taken from the firm's balance sheet or statement of financial position (so-called book value).

$$\text{Debt to equity ratio} = \frac{\text{Total debt}}{\text{Total shareholder's equity}} \tag{2.3}$$

4) The financial leverage ratio is the ratio of total assets to total shareholders' equity. The ratio

will also be used in DuPont analysis.

$$\text{Financial leverage ratio} = \frac{\text{Total assets}}{\text{Total shareholder's equity}} \tag{2.4}$$

Coverage financial leverage ratios

There are many other ratios to complete the above ratios. The two most common ratios are the times interest coverage ratio and the fixed charge coverage ratio. The times-interest-coverage ratio, also called the interest coverage ratio, indicating the earning available to meet interest obligation.

$$\text{Interest coverage ratios} = \frac{\text{Earning before interest and taxes}}{\text{Interest payments}} \tag{2.5}$$

The fixed charge coverage ratio is an expansion of interest coverage ratio. It adds some fixed charges, such as lease payments and preferred dividends.

$$\text{Fixed charge coverage ratio} = \frac{\text{Earning before interest and taxes} + \text{lease payments}}{\text{Interest payments} + \text{lease payments}} \tag{2.6}$$

2.2.2 Liquidity ratios

Liquidity ratios measure company´s ability to meets its immediate or short-term liabilities and obligations. They can be used to analyze company´s liquid assets and short-term liabilities and obligations. Liquidity ratios also have some shortages. Because short-term assets and liabilities are easily changed, measures of liquidity can rapidly become out-of-date(Source: Brealey, Myers and Allen (2008), page795.).

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Current ratio

Current ratio indicates a company’s ability to pay off short-term liabilities before the expiration.

This ratio measures the margin of liquidity of a company.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}} \tag{2.7}$$

The higher current ratio, the more liquidity the company is. For most companies, the common acceptable ratio is 2. But 1.5 is the acceptable current ratio for industrial companies.

Quick ratio

Some assets also have high liquidity except cash. When trouble comes, managers often focused on cash, short-term securities and bills which customers have not paid. Quick ratio measures the ability of a company to use its near cash or quick assets to extinguish or retire its current liabilities immediately.

$$\text{Quick ratio} = \frac{\text{Cash} + \text{Short - term investment} + \text{Receivables}}{\text{Current liabilities}} \tag{2.8}$$

Cash ratio

Cash ratio is a ratio that measures a company's liquidity and ability to repay its short-term debt. And cash and marketable securities of a company is the most common liquid assets.

$$\text{Cash ratio} = \frac{\text{Cash} + \text{Short - term maketable investments}}{\text{Current liabilities}} \tag{2.9}$$

In general, if liquidity ratios are higher, it means that a company has a better ability to meet its immediate needs and pay off its short-term debt. When cash ratio of a company is less than 1, it means that the company can not pay back short-term liabilities currently. That is a bad situation for the company.

2.2.3 Activity ratios

Activity ratio measures how well a company uses its assets. If the assets of a company is of efficiency, they will make a profit. The assets efficiency utilization has a direct impact on liquidity.

Inventory turnover

Inventory turnover is a measure of the number of times inventory is sold or used in a time period such as a year. A low turnover rate may point to overstocking. However, in some instances a low rate may be appropriate, such as where higher inventory levels occur in anticipation of rapidly rising prices or expected market shortages. Conversely a high turnover rate may indicate inadequate inventory levels, which may lead to a loss in business as the inventory is too low. This often can result in stock shortages. Some compilers of industry data use sales as the numerator instead of cost of sales[1].

$$\text{Inventory turnover} = \frac{\text{Cost of goods sold}}{\text{Average inventory}} \tag{2.10}$$

Receivables turnover

Receivable turnover ratio indicates the number of times, on average, receivables (e.g. accounts receivable) are collected during the period. We can know how efficient the company collects their receivables they made.

[1] This sentence is from INV.ESTOPEDIA. The website is below:
http://www.investopedia.com/terms/i/inventoryturnover.asp

$$\text{Receivables turnover} = \frac{\text{Total revenue}}{\text{Average receivables}} \tag{2.11}$$

Besides, it can be converted into another ratio called average collection period. Due to the size of transactions, most businesses allow customers to purchase goods or services via credit. Therefore, keeping a lower average collection period is necessary, because this means that it does not take a company very long to turn its receivables into cash.

$$\text{Average collection period} = \frac{\text{Average receivables}}{\text{Sales/365}} \tag{2.12}$$

Long-term assets turnover

The long-term assets turnover ratio shows the ability to generate net sales from long-term assets investments - specifically property, plant and equipment - net of depreciation.

$$\text{Long-term assets turnover} = \frac{\text{Revenue}}{\text{Average long-term assets}} \tag{2.13}$$

Total assets turnover

Total assets turnover ratio measures the efficiency of a company's use of its assets in generating sales revenue or sales income to the company. We can know how quickly a company can invert their assets into revenues.

$$\text{Total assets turnover} = \frac{\text{Total revenue}}{\text{Total assets}} \tag{2.14}$$

2.2.4 Profitability ratios

Profit is a ultimate aim of every company. The key aim for a company is to make every effort to earn a great profit. This ratio gives us an idea of what makes up a company’s income and the ability for company to make a profit. The higher the profitability ratios， the better competitive position of the company. It is of significance to value a company. There are four types ratios to measure it.

Gross profit margin

Operating profit is the profit before interest and taxes. Operating profit relative to total revenues gives an operating profit margin which can be calculated as

$$\text{Gross profit margin} = \frac{\text{Gross profit}}{\text{Total revenue}} \quad . \qquad (2.15)$$

Net profit margin

Net profit margin is also known as gross profit margin. It measures the profitability of a company after accounting for all costs. It is an indicator of profitability and is often used to compare the profitability of companies and industries of different sizes.

$$\text{Net profit margin} = \frac{\text{Net profit}}{\text{Total revenue}} \qquad (2.16)$$

Return on assets (ROA)

Investors often measure the performance of a company by the ratio of income to total assets. This is known as return on assets. It is a core indicator of the efficiency of comprehensive utilization of assets.

$$\text{Return on assets} = \frac{\text{Net profit}}{\text{Total assets}} \qquad (2.17)$$

Return on equity (ROE)

Another measure focuses on the return on the company's equity:

$$\text{Return on equity} = \frac{\text{Net profit}}{\text{Total equity}} \tag{2.18}$$

It can be used for measuring a company's ability to generate profit from every unit of shareholders' equity. In general, it is good for an investor to invest a company in a long term when ROE of a company is more than 15% and is increasing stable. But if ROE is more than 40%, the company might as well to operate financial means of forgery.

2.2.5 Market ratios

When investors want to know the market value of a company, they will focus on market ratios. The ratios are evaluating the current market price of a share of common stock and regard them as an indicator of the company's ability to generate profits or assets held by the company.

EPS (earnings per share)

Earnings per share ratio is one of the important indicators for measuring the value of equity investments. It is a basis for analysis of per share value index and an important indicator of the comprehensive reflection of the profitability of the company. The higher the ratio, the more profit the company gets.

$$\text{Earnings per share} = \frac{\text{Net profit}}{\text{Number of shares outstanding}} \tag{2.19}$$

Price-to-earnings ratio(P/E)

Investors usually use this ratio to evaluate whether the level of stock price is reasonable. If a company has high P/E ratio, it indicates that most investors believe that EPS will growth rapidly and go down to a reasonable level after several years. P/E ratio is also an important indicator to measure profitability of a joint stock company.

$$\text{Price-to-earning ratio} = \frac{\text{Market price per share}}{\text{EPS}} \tag{2.20}$$

Dividend payout ratio

Investors can find blue-chip stocks by comparing companies'dividend payout ratio. It is a reflection of dividend policy of a company. Different companies have different dividend policy. A large proportion of the profit of a company with potential growth will be retained to make some investment and dividend payout ratio will be lower. On the contrary, a company with mature financial position will distribute a large proportion of profit to the shareholders.

$$\text{Dividend payout ratio} = \frac{\text{Dividends paid}}{\text{Net profit}} \tag{2.21}$$

2.3 DuPont analysis

DuPont analysis is a method that comprehensively analyzes the financial position of a company. The name comes from the DuPont Corporation that started using this formula in the 1920s. This ratio measures the ability of a company to make a profit and the level of shareholder's equity return. It evaluates the performance of a company. The basic idea is to break down return on net assets into three distinct elements. This analysis enables the analyst to understand which factors have impact on its value or evolution. The basic formulas are below:

$$\text{Return on equity} = \frac{\text{Net profit}}{\text{Equity}} = \frac{\text{Net profit}}{\text{Revenues}} \cdot \frac{\text{Revenues}}{\text{total assets}} \cdot \frac{\text{Total assets}}{\text{Equity}} \tag{2.22}$$

is broken down ROE into three parts. The first component is net profit margin, then second one is assets turnover and financial leverage is the last one. This decomposition makes the level of financial ratio analysis is more clear and prominent. It is convenient for analysts to understand the operating activities and performance of a company.

2.4 Gradual changes analysis

Gradual changes analysis is a method for quantification of influence. The analysis is able to quantify the change in the basic ratio caused by change in the component ratio.

In the case of decomposition with three components ratios, it can be expressed as:

$$\begin{aligned} \Delta x_{a_1} &= \Delta a_1 \cdot a_{2,0} \cdot a_{3,0} \\ \Delta x_{a_2} &= \Delta a_{1,1} \cdot \Delta a_2 \cdot a_{3,0} \\ \Delta x_{a_3} &= a_{1,1} \cdot a_{2,1} \cdot \Delta a_3 \end{aligned} \quad , \qquad (2.23)$$

in which the meaning of the symbols are listed as follows:

x – basic ratio

Δx – absolute change in the basic ratio

a – component ratio .

3 The Yum! company overview

Yum! Company is focused on driving aggressive international expansion and building strong Company everywhere. Yum! Company has more than 14,500 restaurants outside the U.S., they are distributed in 122 countries and territories2. In this chapter, some basic information about Yum! Company will be introduced in detail at first, then the scale of the company in the world will be described. After that we will focused on the development of the company in China. The history and strategies will be the following part. At last, main competitors will be compared with Yum!. The main source of this part is from annual report 2011 and annual report 2012 of this company.

3.1 Introduction of Yum! Company in the world

Yum! Company is a United States-based Fortune 500 corporation. Yum! Operates Taco Bell, KFC, Pizza Hut, and WingStreet restaurants worldwide. Prior to 2011, Yum! also owned Long John Silver's. Yum! operates throughout the world in 73 countries. Yum! has made incredible progress in India, opening 101 new restaurants in 2011. It also made stellar progress in Russia. When their primary competitor makes over $300 million in Russia, they just get already to enter into the fast food restaurant market in Russia. Then they arranged a strong Russian leadership team to implement a series of initiatives that will build a powerful business for the long term. Besides, they are making growth in the continent of Africa that they have built 656 stores in South Africa. They entered Zambia, Ghana and Kenya in 2011 and 7 new countries in 2012, in addition to expanding our equity presence and adding new units in South Africa. The company has about 58 Yum! restaurants per million people in the U.S. But they only have fewer than 2 restaurants per million people in the top 10 emerging markets. So Yum! has more space to develop and growth.

[2] The data is from annual report of the company,2012.

3.2 Activities of Yum! Company in China

Yum! Company is focused on building leading Company in China in every significant category. They are the leading retail developer in China with more than 5,700 restaurants in more than 850 cities. You can find KFC, Pizza Hut almost everywhere in big city in China. There are many people visiting the restaurants of Yum! Company. In this case, Yum! Company is well known in China.

In 2011, more than a half of their operating profit is generated in China and the 72 other emerging countries in which they open throughout the world. China is viewed as the best restaurant growth opportunity of the 21^{st} century. Based on the company's annual report in 2012, KFC now has 4,260 restaurants in over 850 cities throughout China and continues to expand their scale. Pizza Hut Casual Dining now has 626 units and is successfully expanding in lower-tier cities. The strategy of the company is to offer variety of foods, everyday value and refresh 25% of its menu twice per year which has consistently driven sales and profit growth. In China, the consuming class is expected to double over the next 10 years, going from 300 million to at least 600 million people, as significant urbanization continues. By the way, their new-unit development pace could continue at a high rate, and same store sales should grow too.

Yum! Company open more than one new KFC every day in China. In addition to original recipe chicken, KFC has an extensive menu featuring beef, seafood, rice dishes, fresh vegetables, soups, breakfast, desserts, and other products that appeal to Chinese consumers'tastes[3]. Also Pizza Hut Casual Dining has an extensive menu offering a broad variety of pizzas, entrees, pasta, rice dishes, appetizers, beverages and desserts.

3.3 History of KFC, Pizza Hut and Taco Bell

KFC Corporation, based in Louisville, Kentucky, is one of the few Company in America that

[3] The information is from WIKIPEDIA. More information will be found on the following website: http://en.wikipedia.org/wiki/KFC

can be proud of having a rich, 60-year history of success and innovation. Since its founding by Colonel Harland Sanders in 1952, KFC has been serving customers delicious, already prepared complete family meals at affordable prices. There are over 18,000 KFC outlets in 120 countries and territories around the world.

Pizza Hut, Inc., based in Plano, Texas, is the world's largest pizza restaurant, specializing in the pizzas you never have to settle for - pan pizza, thin 'n crispy® pizza, hand-tossed style pizza and stuffed crust pizza. Pizza Hut started in 1958 when a couple of brothers borrowed $600 from their mother to start a pizza restaurant. The brothers opened their first restaurant by the Wichita State University campus in Kansas. The brothers, Frank and Dan Carney, were students at the school. It did not take long for Pizza Hut to branch out. Due to the success at the Wichita location, the first franchised store opened up in Topeka, Kan., one year later. By 1966, Pizza Hut established a large home office in Wichita to help oversee the 145 Pizza Hut franchise restaurants that were established[4].

Taco Bell Corp., based in Irvine, California, is the nation's leading Mexican-style chain serving tacos, burritos, signature quesadillas, Border Bowls®, nachos and other specialty items. Today, Taco Bell serves more than 35 million consumers each week in more than 5,200 restaurants in the U.S. Since its founding by Glen Bell in 1962, the company's countless innovations have changed the very nature of the QSR industry. From revolutionizing new kitchen preparation systems and supply chain management processes to establishing its Value Leadership, Taco Bell has kept alive Glen's pioneering spirit. "Live Mas®" is more than a company tagline; it's a way of life at Taco Bell.

3.4 Strategies and principles

Across the globe, Yum! Company has claimed that they will continue to execute against the following strategies(Annual report, 2011, page10):

1. Build leading Company in China in every significant category.
2. Drive aggressive international expansion and build strong bands everywhere.

[4] The history of Pizza Hut is based on the official website of Pizza Hut: http://www.pizzahut.co.uk/restaurants/our-history.aspx

3. Dramatically improve U.S. brand positions, consistency and returns.

4. Drive industry -leading, long-term shareholder & franchisee value.

According to the strategies, they can realize their aim better and faster. It should be good for driving shareholders' value and making the world a better place by building the company around three principles:

1. Creating a famous recognition culture where everyone counts. This company have the belief that the best way to get results is by having fun recognizing others and operating with a deep-seated conviction that everyone at every level can truly make a difference. In this case, Yum! can easily share one culture and have mutual aim with others. And this will drive the company's future success.

2. Building dynamic, vibrant Company everywhere with one system operational excellence as their foundation. Each Company of Yum! has unique spirit. Taco Bell is looking after pioneering spirit and they offering unbelievable value. KFC gives consumers joyful eating experiences with better taste. Pizza Hut promotes social interaction because it has create a favorite moment for you and your lover or your friends.

3. Being a company with a huge heart. Making profit is not the most important things to them. Another idea is that they care about the world and do not want to save the people who are at the risk of starvation and continue to build their partnership with the United Nations World Food Programme.

3.5 Yum! 's main competitors

Any fast food restaurant will be Yum!'s competitor. Some of them are just have small shares in the market and will not be a threaten of the company. Usually they are individual enterprises. But some of them have more than half shares in the market. So it will be a big threaten for Yum!.

Figure 3.1 Top 10 quick-serve and fast-casual Company in US

QSR 50 RANK	COMPANY/CHAIN NAME	2011 U.S. SYSTEMWIDE SALES (MILLIONS)	2011 U.S. AVERAGE SALES PER UNIT (THOUSANDS)	NUMBER OF TOTAL UNITS IN 2011	TOTAL CHANGE IN UNITS FROM 2010
1	McDonald's	$34,172.0	$2,500.0	14,098	71
2	Subway*	$11,400.0	$469.0	24,722	872
3	Starbucks*1	$9,750.0	$1,140.0	10,821	-310
4	Wendy's*	$8,500.0	$1,456.0	6,594	18
5	Burger King*	$8,400.0	$1,248.0	7,231	-33
6	Taco Bell	$7,000.0	$1,284.0	5,670	36
7	Dunkin' Donuts*	$6,500.0	$850.0	7,015	115
8	Pizza Hut	$5,500.0	$875.0	7,600	58
9	KFC	$4,500.0	$940.0	4,780	-275
10	Chick-fil-A	$4,051.0	$2,893.5	1,606	69

Source : http://www.qsrmagazine.com/reports/qsr50-2012-top-50-chart

According to the Figure 3.1, we can clearly see that McDonald and Subway are the main competitors. For this reason, some information about these two companies will be given and compared with Yum! Company.

McDonald's corporation

McDonald's Corporation is the main competitor of Yum! Company. The two companies are both the world's large restaurant chains. McDonald's offers the world's most delicious burgers. Its first restaurant was opened in 1955 by brothers Mac and Dick McDonald. Today thousands of its outlets worldwide are earning revenue of $24 billion every year. Tasty burgers and simple menu has made McDonald's become a popular restaurant all over the world.

McDonald's Corporation sells various types of foods, it sells hamburger, chicken sandwiches, french fries, soft drinks, breakfast items, and desserts. In most markets, McDonald's offers salads and vegetarian items, wraps and other localized fare. On a seasonal basis, McDonald's offers the McRib sandwich. Some speculate the seasonality of the McRib adds to its appeal[5]. Different countries serve different menu, especially in Asia, are currently serving soup.

[5] The sentence is from"Fanatics Preach Fast Food Evangelism. Fox News. 2011-07-23"

Notably, McDonald's has increased shareholder dividends for 25 consecutive years[6].

According to the data, MacDonald's is indeed a strong competitor. In the following, their revenues will be compared and the differences will be shown.

Table 3.1 Comparison of revenues of MacDonald's and Yum! (USD million)

year	2008	2009	2010	2011	2012
MacDonald's revenue	23522	22745	24075	27006	27587
Yum!'s revenue	11304	10836	11343	12626	13633

Source: Annual Reports(2008-2012) Author

As the table shows, MacDonald's revenues is much more than Yum!'s. And MacDonald's revenue is almost twice as Yum!'s. Although Yum! is already a successful fast food restaurant chain, MacDonald's is larger and more efficient. Why is that? The possible reasons are as follows. Firstly, I found MacDonald's was selling hamburgers to start a business. And KFC is selling fried chicken at the beginning. People thought eating hamburger is better than fried chicken because hamburger can serve as staple food but fried chicken is just snacks. So if people want to be full and the same price, they will choose hamburger. Secondly, most McDonald's restaurants offer both counter service and drive-through service, with indoor and sometimes outdoor seating. It is convenient to people who have different needs. For example, like "Mac Drive", it is known in many countries. You can just pay for the bill and pick up orders. Thirdly, every year MacDonald's will choose a famous people to be their spokesman. And this action will increase the brand's goodwill and popularity.

Subway

From a small sandwich shop, Subway has boomed into the largest submarine sandwich chain across the globe. Since its appearance in 1965, Subway continues to increase its scale through its image as a delicious, healthy and fresh alternative among popular fast-food restaurants. It is one of the favorite destinations for lovers who like fast and healthy food in more than 86 countries. At the end of 2010, Subway becomes the largest fast food chain worldwide, with 33,749 restaurants even more than McDonald's with 32737 restaurants[7]. But the revenues are

[6] The source is from the website in the following: http://en.wikipedia.org/wiki/McDonald's

[7] The data is from the following website:

still less than MacDonald's.

Subway is a fast-food restaurant chain which develop quite fast. It mainly provides submarine sandwiches. In addition, it also provides salad, cookies, doughnuts and muffins. Subway's menu varies between countries, stores will create different menu with meat according to the place where they are. It is different from Yum!. But they are all fast food. Why Subway is more acceptable by people?

One reason is that Subway has an excellent advertisement strategy. Subway uses the advertising slogan "Eat Fresh", and focuses on how their sandwiches are made from freshly baked bread and fresh ingredients. Then in November 2007, Subway's US commercials featured the cartoon character Peter Griffin (from Family Guy) promoting its new Subway Feast sandwich[8]. In a word, Subway has made a lot of efforts to advertise its own brand. These programs have made Subway become young people's famous brand and improve the popularity.

Another important reason is Subway provides lower energy food while Yum! always provides higher one. Now people in modern cities are easier to be fat. They are usually working in the office and have less time to do exercises. So they usually choose fast food, but most of fast food contains high calorie. Subway provides food with lower calories fast food. This will be a new trend for fast food. In this case, Subway are more fashionable and acceptable.

In the following, some charts is shown the two companies' stock price in five years. We can clearly see the trend and differences.

Chart 3.1 Yum!'s stock price in 5 years

http://online.wsj.com/article/SB10001424052748703386704576186432177464052.html

[8] The information is found from the website: http://en.wikipedia.org/wiki/Subway_(restaurant)

Chart 3.2 MacDonald's stock price in 5 years

Source: http://finance.yahoo.com/q?s=YUM
http://finance.yahoo.com/q?s=MCD

Viewing the stock price over time, the gradual trend of the two companies is actually the same. Yum!'s stock price increase from $40 to $70 in recent three years. MacDonald's stock price increase from $74 to $100 in recent three years. The stock price of MacDonald's is in the higher lever. But the growth rate of Yum! is about 75%, which is much more than MacDonald's 38%. In this case, Yum! makes better performance than MacDonald.

4 Financial analysis of Yum! Company

This part is focused on the financial analysis of Yum! Company. This company is analyzed by using three basic methods. They are common-size analysis, financial analysis and DuPont analysis. These methods will help to analyze the company's performance and figure out why the data changed over time. In this part, all the data are based on balance sheet, income statement and cash flow which are shown in annexes.

4.1 Common-size analysis

The aim of this method is to compare the changes and identify the trends and major differences between different sizes of companies. Two kinds of common-size analysis will be introduced.

4.1.1 Vertical common-size analysis of income statement

The vertical analysis is the most common analysis of common-size analysis. All the items are restated as a percentage of the benchmark which is revenue of each year.

Table 4.1 Vertical analysis of income statement

Year	2007	2008	2009	2010	2011
Revenue	100%	100%	100%	100%	100%
Cost of sales	74.5%	74.9%	73.2%	71.6%	72.4%
Administrative expenses	12.4%	11.9%	11.3%	11.3%	10.9%
Other operating expenses	0.1%	-0.2%	0.8%	1.6%	2.4%
Interest expenses	1.6%	2.0%	1.8%	1.5%	1.2%
Non-operating income	0.0%	0.1%	0.1%	0.2%	0.1%
Taxation	2.7%	2.8%	2.9%	3.7%	2.6%
Net profit for the year	1.2%	8.5%	9.9%	10.2%	10.4%

According to chart 4.1, the percentage of cost of sales takes the most even around 75%. From 2007 to 2010, the cost of sales was decreasing over the time at a moderate lever. It indicates that the company cuts down the costs to increase the profit because of the the financial crisis during these years. But after 2010, the cost increased.

Chart 4.1 Vertical analysis of income statement

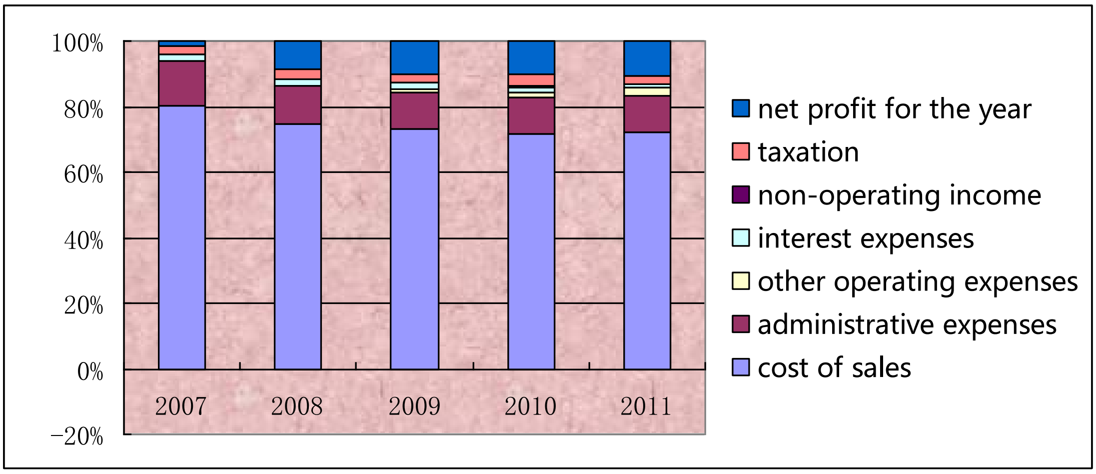


Table 4.2 Detailed items of costs in income statement

Year	2007	2008	2009	2010	2011
Food and paper	2,824	3,239	3,003	3,091	3,633
Payroll and employee benefits	2,305	2,370	2,154	2,172	2,418
Occupancy and other operating expenses	2,644	2,856	2,777	2,857	3,089
Company restaurant expenses	7,773	8,465	7,934	8,120	9,140
General and administrative expenses	1,293	1,342	1,221	1,277	1,372
Franchise and license expenses	59	99	118	110	145
Closures and impairment (income) expenses	35	43	103	47	135
Refranchising (gain) loss	-11	-5	-26	63	72
Other (income) expense	-71	-157	-104	-43	-53
Total costs and expenses, net	9,078	9,787	9,246	9,574	10,811

Seen from table 4.2, it shows the detailed items of total costs over the period from 2007 to 2011. Almost all the costs are increasing in 2011. Partly reason should be the price of raw materials of food is going up compared with the previous year. And another reason is that Yum! has opened more than 1000 new units in 2011. So the management expenses and related costs increased. But it is good news for the company because the investment will make a profit in the future. Besides, we can clearly see that the percentage of net profit is rising up over the time from chart 4.1. This is absolutely a good trend for the company. For many other companies, they made loss in 2008 or 2009 because of financial crisis in the world. As I know, financial crisis in 2008 has a big impact on most companies. Even some small companies went to bankrupt. Fortunately, there is little affection on Yum! Company. It still made a profit and stand up strongly. It is fully shows Yum! is strong enough to overcome some crisis and difficulties. On the other hand, everyone must eat food even if they earn less money or have no jobs. Yum! is cheaper compared with other non-fast-food restaurant. In that situation, people will prefer Yum! to cut their costs.

4.1.2 Vertical common-size analysis of balance sheet

Total assets is chosen as the benchmark in vertical analysis of balance sheet. Other items are stated as a percentage of total assets.

Table 4.3 Vertical analysis of balance sheet

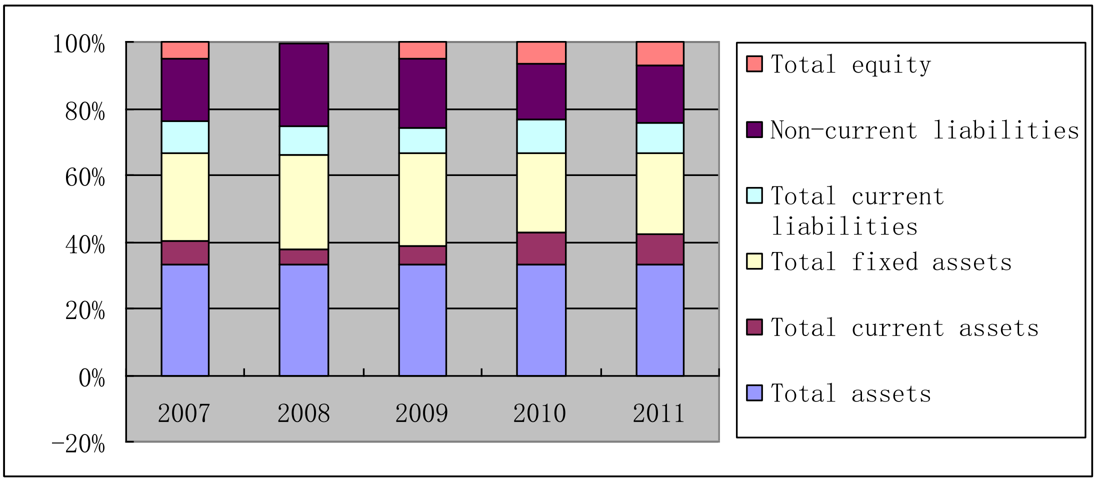
Year	2007	2008	2009	2010	2011
Total assets	100%	100%	100%	100%	100%
Total current assets	20.45%	14.57%	16.90%	27.81%	26.27%
Total fixed assets	79.55%	85.43%	83.10%	72.19%	73.73%
Total current liabilities	28.47%	26.38%	23.13%	29.44%	27.73%
Non-current liabilities	55.80%	75.06%	61.29%	50.49%	50.58%
Total equity	15.73%	-1.44%	15.58%	20.07%	21.69%

The percentage of total current assets in 2008 is much lower than other years while the percentage of non-current liabilities in 2008 is much higher than other years in chart 4.2. As we all know, American's sub-prime crisis in 2007 has a bad influence on the world's economy.

Most companies are at a loss in 2008. So it has no exception for Yum!. When the world's economy is going bad, consumers will cut their spending. Then companies' return will be less but investments for operating activities will not stop. Correspondingly, current assets will also decrease. Because the investment can not convert to profit immediately when the company is in a bad situation. At the same time, non-current liabilities increased as the company can't afford to pay loans back. From the table 4.3, we can see that the current assets is going up after 2009. This situation indicates the economy is getting better and the influence of sub-prime crisis faded over the time.

It is obvious to see that there is a negative number in the table 4.3. Total equity in 2008 is -1.44% of total assets. When the company has been losing so much money which is more than total equity, total equity will be negative as a percentage of total assets. In this regard, financial crisis has a big and bad adverse impact on Yum! Company.

Chart 4.2 Vertical analysis of balance sheet



4.1.3 Horizontal common-size analysis of income statement

The year 2007 is regarded as the benchmark, each item is restated as percentage compared with the base year. Some items of income statement are restated in the following table 4.4 which is used for analyzing the trend and the growth over the period of time.

Table 4.4 Horizontal analysis of income statement

Year	2007	2008	2009	2010	2011
Revenue	100%	108.33%	103.84%	108.70%	121.00%
Cost of sales	100%	108.90%	102.07%	104.46%	117.59%
Administrative expenses	100%	103.79%	94.43%	98.76%	106.11%
Other operating expenses	100%	-166.67%	758.33%	1475.00%	2491.67%
Operating profit	100%	111.79%	117.17%	130.36%	133.75%
Interest expenses	100%	136.14%	116.87%	105.42%	93.98%
Taxation	100%	113.12%	110.99%	147.52%	114.89%
Net profit for the year	100%	106.05%	117.82%	127.39%	145.10%

When regarded 2007 as a benchmark, we can find revenue is decreasing from 2008 to 2009. The most probable cause is financial crisis in 2008. A negative number appeared in 2008 in table 4.4. Other operating expenses is -166.67% of the lever in 2007. It is abnormal. Tracing the reason, let's focus on table 4.5.

Table 4.5 Detailed items of other operating expenses

Year	2007	2008	2009	2010	2011
Franchise and license expenses	59	99	118	110	145
Closures and impairment (income) expenses	35	43	103	47	135
Refranchising (gain) loss	-11	-5	-26	63	72
Other (income) expense	-71	-157	-104	-43	-53

From table 4.5, we find the main reason which caused the negative number is other income are very high. Tracing other expense in 2008, gain upon sale of investment in unconsolidated affiliate in 2008 is 100, which is much more higher than 2007[9]. The mainly reason is that the gain recognized on the sale of their interest in Yum!'s unconsolidated affiliate in Japan. In December 2007, they sold their interest in their unconsolidated affiliate in Japan. And their

[9] The information is found in annual report, 2008, page 158.

international subsidiary that owned this interest operates on a fiscal calendar with a period end that is approximately one month earlier than our consolidated period close. So this amount of money is recorded in 2008 which caused higher other expense. Besides, the information can be found in table 4.4 that the other operating expenses of 2009, 2010 and 2011 are much more higher than 2007. Especially from 2009 to 2011, the growth rate is approached to 100%. The obvious cause can be seen in table 4.5, franchise and license expenses is higher and higher over time. In recent years, Yum! Company has opened new units every year and they are expanding their scale quickly[10]. The increase of franchise and license expenses was driven by higher marketing funding on behalf of franchisees, investments in their U.S. Company and increased provision for uncollectible receivables.

Besides, impairment expense is much higher in 2009 and 2011 than other years. If the carrying value of the assets can not be recoverable,the impairment will be measured based on the excess of their carrying value over their fair value[11]. So it indicates there are more assets can not be used for better return in 2009 and 2011. The company maybe make some new investment to insure better operating activities.

4.1.4 Horizontal common-size analysis of balance sheet

Some selected items of assets are in the form of percentage of the benchmark 2007 and presented in the table (Table 4.6). Firstly, total current assets of 2008 and 2009 can be found lower than the lever of 2007. Viewing all the items of total current assets, the major difference is cash and cash equivalents of 2008 and 2009 are lower. It indicates the liquidity in 2008 and 2009 is worse than 2007. Because the company has more loans to pay in 2008 which is a bad economy year. But after 2008, the situation is getting better. The company has paid more attention to control their liquidity.

[10] The data can be found in the part " Dear Partners" of annual report of each year. That report how many new units the company opened in that year.

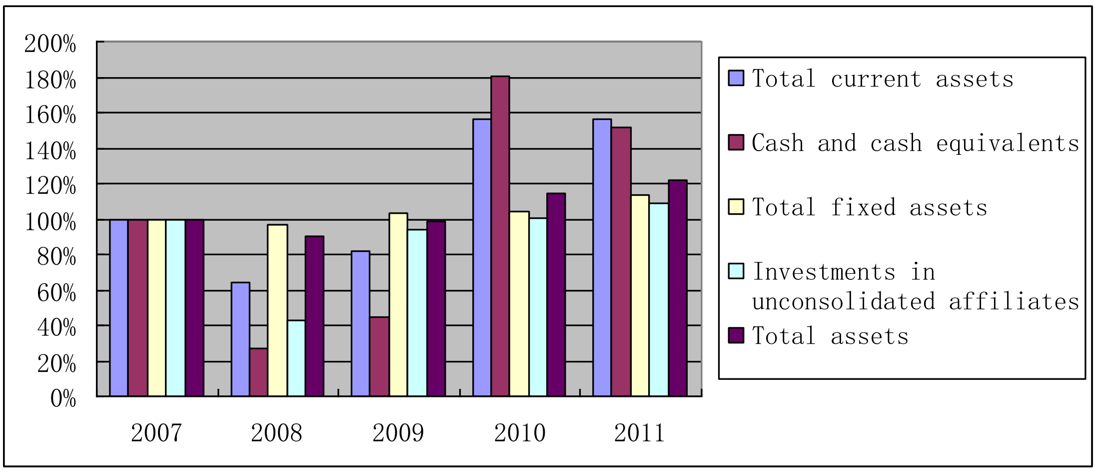
[11] The thought is based on the annual report,2011,page160.

Table 4.6 Horizontal analysis of assets

Year	2007	2008	2009	2010	2011
Total current assets	100%	64.21%	81.57%	156.18%	156.72%
Cash and cash equivalents	100%	27.38%	44.74%	180.74%	151.84%
Total fixed assets	100%	96.79%	103.11%	104.20%	113.05%
Investments in unconsolidated affiliates	100%	42.48%	94.12%	100.65%	109.15%
Total assets	100%	90.13%	98.70%	114.83%	121.98%
Accounts and notes receivable, net	100%	101.78%	106.22%	113.78%	127.11%
Inventories	100%	111.72%	95.31%	147.66%	213.28%
Accounts payable and other current liabilities	100%	89.27%	85.64%	97.09%	113.58%

Besides, investments in 2008 and 2009 is also lower than the lever of 2007. Especially in 2008, the investment is less than a half in 2007. It means the company has opened less new units than in 2007. Maybe it was because the economy is in a downturn period. Another important change has been found here, inventories in 2011 is two times of the lever in 2007. This is not a good trend. If the inventory is too much, it will cost too much especially for restaurants.

Chart 4.3 Horizontal analysis of assets



It can be seen from chart 4.3 that total fixed assets are growing gradually. That shows the company is expanding and developing over time. In contrast, investments in unconsolidated affiliates in 2008 is not common. It is much lower than other years. “We record impairment charges related to an investment in an unconsolidated affiliate whenever events or circumstances indicate that a decrease in the fair value of an investment has occurred which is other than temporary.”(annual report,2011, page161) As we know that 2008 is an unusual year, it is a period of economy downturn. The company’s investments may not get high return. That’s the mainly reason caused investments in unconsolidated affiliates of 2008 is the lowest during the five yeas.

Table 4.7 Horizontal analysis of equity

Year	2007	2008	2009	2010	2011
Retained earnings	100%	27.08%	89.01%	153.44%	183.38%
Accumulated other comprehensive loss(income)	100%	-2090%	-1120%	-1135%	-1235%
Total Shareholders’ Equity	100%	-9.48%	89.99%	138.37%	160.05%

It is clear from table 4.7, retained earnings in 2008 and 2009 are lower than 2007. Because the sum of the dividends distributed on common stock and repurchase of shares of common stock are much more than net income. So the retained earnings is less. After 2009, net income is getting more, so he retained earnings are more. Besides, accumulated other comprehensive loss from 2008 to 2011 is negative in the table. It is seen so strange, especially the data in 2008. It is about twenty times more than the lever in 2007. According to the annual report of 2008, I have found the actual reason for that is foreign currency translation adjustment arising during 2008 and net unrealized loss on derivative instruments. These two activities cost too much which caused negative total shareholders’ equity. After 2008, the company has gained 176 million dollors from foreign currency translation adjustment in 2009. So the percentage of accumulated other comprehensive loss is getting higher.

4.2 Financial ratios analysis

Financial ratios analysis is used for measuring a company's liquidity, profitability, assets utilization and so on. It is very useful for evaluating a company's financial position.

4.2.1 Financial leverage ratios

We will distinguish between two types of financial leverage ratios. One is component-percentage financial leverage ratios, another is coverage financial leverage ratios.

Component-percentage financial leverage ratios

The items below is used for calculating debt to assets ratio, long-term debt to assets ratio, debt to equity ratio and financial leverage ratio.

Table 4.8 Data for financial leverage ratios

Year	2007	2008	2009	2010	2011
Total debt	6,103	6,621	6,034	6,647	6,918
Long term debt	2,924	3,564	3,207	2,915	2,997
Total shareholders' equity	1139	-108	1,025	1,576	1,823
Total assets	7242	6527	7148	8316	8834

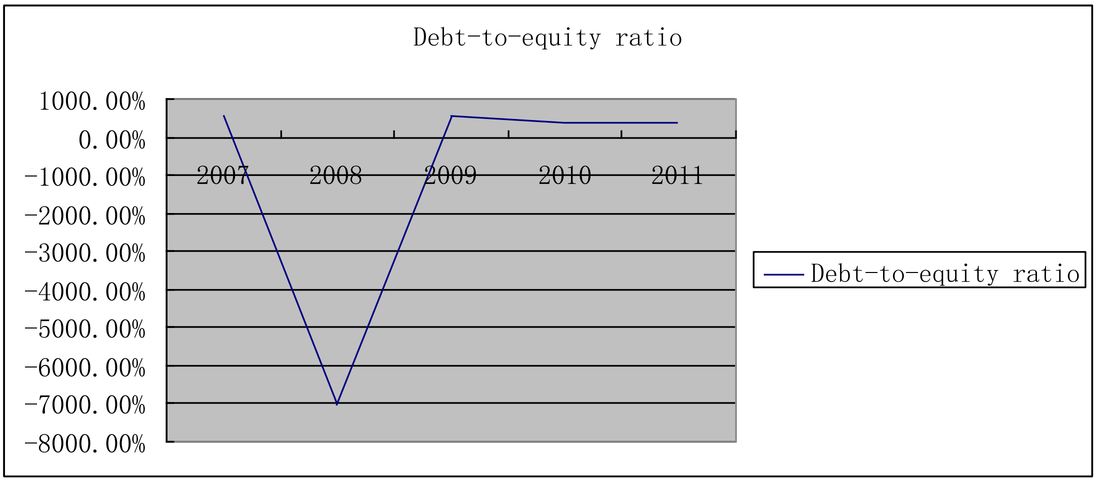
According to the data, we can get the ratios below:

Table 4.9 Component-percentage financial leverage ratios of Yum! Company

Year	2007	2008	2009	2010	2011
Debt to equity ratio	535.82%	-6130.56%	588.68%	421.76%	379.48%
Debt to assets ratio	84.27%	101.44%	84.42%	79.93%	78.31%
Long term debt to assets ratio	40.38%	54.60%	44.87%	35.05%	33.93%

According to table 4.9, it can be seen that long term debt to assets is increasing from 2007 to 2008, and then decreasing from 2008 to 2011. We have known that economy in whole world is horrible after financial crisis in 2008. Yum! don't have enough money to pay the long term debt also. So they have more long term debt relatively. Since the economy of the world is getting better, they paid the loans and adjust their capital structure to ensure the optimality of capital.

Chart 4.4 Debt to equity ratio



As is shown in chart 4.4, we can see a valley in the year 2008. It seems to be steeply and strangely. Tracing the reason, the data can be seen from the table 4.8. we can find total equity of 2008 is negative. It seems that the debt in 2008 is too much. The company can not make enough profit to be distributed to the shareholders.

Interest coverage ratio

Table 4.10 Interest coverage ratio

Year	2007	2008	2009	2010	2011
EBIT	1,357	1,517	1,590	1,769	1,815
Interest payments	166	226	194	175	156
Interest coverage ratio	8.17	6.71	8.20	10.11	11.63

Table 4.10 shows that interest coverage ratio is going down from 2007 to 2008 and then is rising up from 2008 to 2011. When the ratio decreases, it is a reflection that the operating profit is less or interest payments is increasing. Both the two cases are bad for the company. It is a signal that the interest burden is heavy. In general, the financial position of the company is not good in 2008. After 2008, the situation is getting better.

4.2.2 Liquidity ratios

How liquid is Yum! Company? If Yum! has borrowed short-term loans, at the same time it has to pay a large bills. The company should have enough money to pay the interest. High liquidity of a company is very important. Liquidity ratio is a significant indicator for evaluating a company.

Table 4.11 Data for liquidity ratios

Year	2007	2008	2009	2010	2011
Total Current Assets	1,481	951	1,208	2,313	2,321
Total Current Liabilities	2,062	1,722	1653	2,448	2,450
Cash and cash equivalents	789	216	353	1426	1198
Receivables	225	229	239	256	286

Current ratio

It measures a company's ability to pay its short-term bills and debt obligations.

Table 4.12 Current ratio of Yum!

Year	2007	2008	2009	2010	2011
Current ratio	0.72	0.55	0.73	0.94	0.94

As can be seen in table 4.12, current ratio of 2008 is the lowest one in the five years. It is likely that the percentage of liabilities in 2008 is more than other years. It seems that financial crisis has a bad influence on Yum!. Besides, it is apparent that current ratios of this five years are less than one. That means net working capital of Yum! is negative. It is not a good trend. We can clearly see the total current assets is increasing after 2008 in table 4.11. But the growth rate of current assets is bigger. It is not good for a company to have too much liabilities. The company should control capital budget in case of imbalance of receivables and payables.

Table 4.13 Current ratio of MacDonald's

Year	2007	2008	2009	2010	2011
Current ratio	0.80	1.39	1.14	1.49	1.25

Source: The data is based on the annual report of MacDonald's.

It can be seen from table 4.13 that most of current ratios during these five years are more than one except the year 2007. It means MacDonald's is in a healthy financial situation. It is better than Yum! Company in this way. Because the higher the current ratio, the higher the liquidity.

Chart 4.5 Comparison of MacDonald's and Yum!

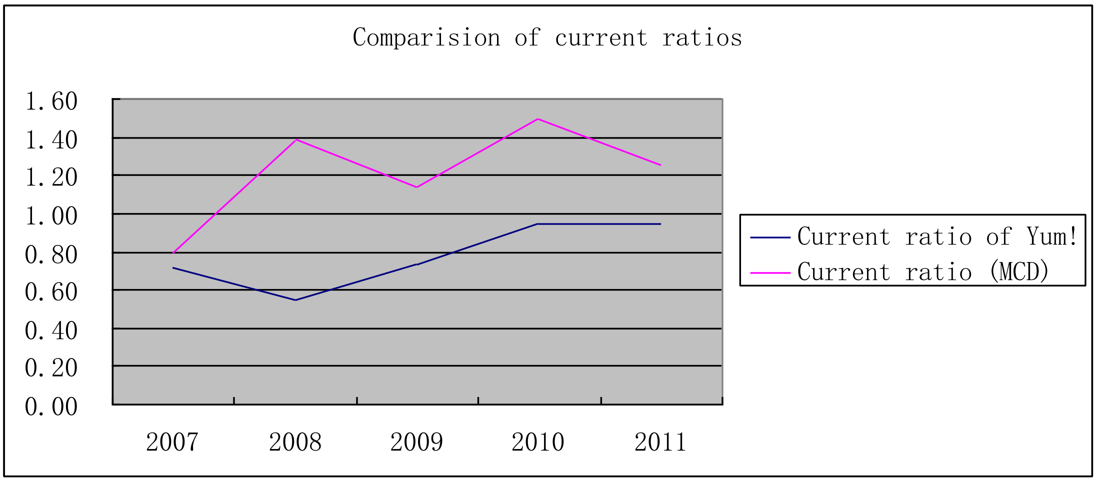


Table 4.14 Comparison of average industry index in May 2 of 2013

INDUSTRY: Restaurants

FINANCIAL CONDITION	COMPANY	INDUSTRY	S&P 500
Debt/Equity Ratio	1.28	0.7	0.97
Current Ratio	0.9	0.7	1.2
Quick Ratio	0.8	0.6	0.8
Interest Coverage	20.9	15.5	34
Leverage Ratio	3.9	2.9	4.1
Book Value/Share	5.09	6.69	24.85

Source:http://investing.money.msn.com/investments/key-ratios?symbol=YUM&page=FinancialCondition

In chart 4.6, the company is represented Yum!. We can see that current ratio of Yum! is higher than industry average lever but is lower than the lever of S&P 500. So Yum! should cut down the percentage of debt to have healthy financial position. Then it can be competitive with other restaurants in this industry.

Quick ratio

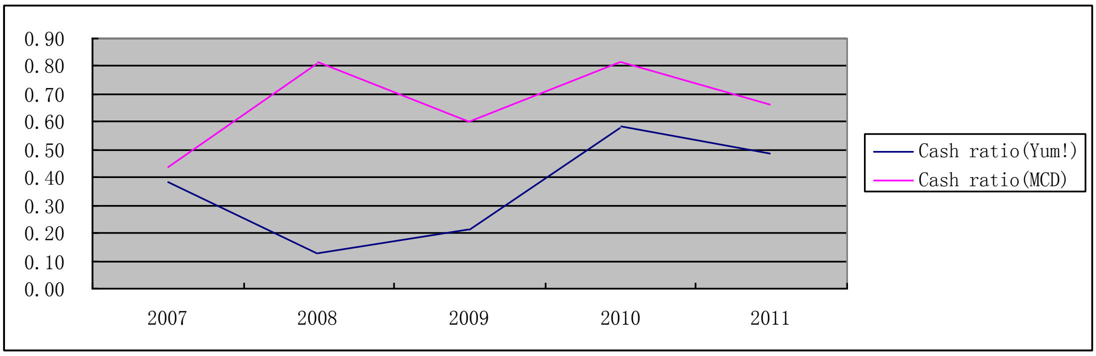
Table 4.15 Quick ratio of MacDonald's and Yum!

Year	2007	2008	2009	2010	2011
Quick ratio(Yum!)	0.49	0.26	0.36	0.69	0.61
Quick ratio(MacDonald)	0.67	1.18	0.96	1.22	1.05

It is apparent from table 4.14 that average quick ratio of MacDonald's is higher than Yum! Company. We have to say the liquidity of MacDonald is much higher. But we can not say Yum! has low liquidity and bad financial position. As we can see the chart 4.6, Yum!'s quick ratio is higher than the industry average and the same with S&P 500. The result seems that Yum!'s current ratio is getting higher over time after 2011. Current assets can be used to meet most of liabilities' obligation.

Cash ratio

Chart 4.6 Comparison of cash ratios



We can see cash ratio of Yum! is entirely under the pink line in chart 4.6.

Chart 4.6 is a curve graph which describes cash ratio of the two companies, we realize cash ratio of Yum! is always lower than MacDonald's. So we can get a general conclusion that the liquidity of MacDonald is higher. Yum! should always prepare cash in case of paying debt when the company is in a state of emergency. In this aspect, MacDonald is in a more healthy financial situation. It is good for the company to proceed further investment.

4.2.3 Activity ratios

There are four types ratios in activity ratios. They are inventory turnover, receivables turnover, long-term assets turnover and total assets turnover. They are all import ratios for measuring how well for a company to use their assets.

Inventory turnover

If we use the data in the balance sheet, we can calculate average inventory. Then we can get inventory turnover in the following table.

Table 4.16 Inventory turnover

Year	2007	2008	2009	2010	2011
Average inventory	110.50	135.50	132.50	155.50	231.00
Inventory turnover	70.34	62.47	59.88	52.22	39.57

Presented in table 4.16, shows the general trend that inventory turnover is decreasing over time. The statistics lead us to the trend that Yum! Company is going to be overstocking. As is shown from the data, we could say the average inventory is more and more over time and it is not good for the company. Another partial reason is that the expansion of Yum! will decrease inventory turnover because more goods need to sell. So inventory will increase in a period. When the restaurants is acceptable by customers, inventory will decrease. But according to the 2012 annual report, the average inventory is 293. It seems the situation is worse. Yum! should pay attention about this ratio and make measures to improve it.

Receivables turnover

Table 4.17 Receivables turnover

Year	2007	2008	2009	2010	2011
Average receivables	222.5	227	234	247.5	271
Receivables turnover	46.90	49.80	46.31	45.83	46.59

According to table 4.17, we can find receivables turnover remained steady at around 45 except for the lever of 2008. Receivables turnover of 2008 is higher shows the collection of accounts receivables is more efficient than other four years. In general, the data can show that the company is quiet efficient for collecting its receivables and it indicates the company has goodwill. From this point, we can find the company is working on achieving the strategy number 2 which I have described in part 2. "Drive aggressive international expansion and build strong bands everywhere."[12]

Long-term assets turnover

Table 4.18 Long-term assets turnover

Year	2007	2008	2009	2010	2011
Average long term assets	5614	5668.5	5758	5971.5	6258
Long term assets turnover	1.86	1.99	1.88	1.90	2.02

It can be seen from table 4.18, the overall trend of long-term assets turnover is going up. It just

[12] The sentence is from annual report 2011, page 10 , which is said by David C. Novak who is the Chairman & Chief Executive Officer of Yum!.

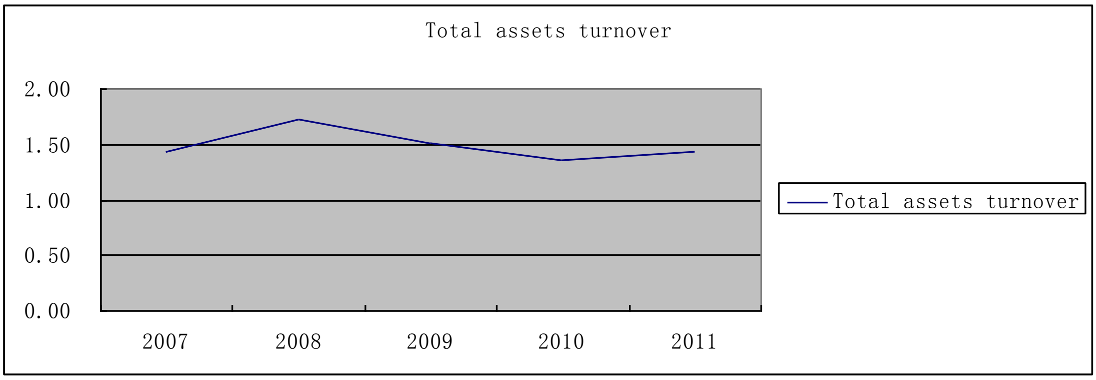
has slight fluctuation. So the ability of the company to generate net sales from long-term assets investment is increasing. This is a good trend for Yum! to get high return.

Total assets turnover

Table 4.19 Total assets turnover

Year	2007	2008	2009	2010	2011
Total assets turnover	1.44	1.73	1.52	1.36	1.43

Chart 4.7 total assets turnover



As shown in chart 4.7, total assets turnover is relatively stable and more than one. It means Yum! can invert its assets to revenue at least once a year. It is a little difficult for most of other companies. In this way, we can say Yum! uses its assets efficiently.

Comparison of MacDonald's and Yum!'s activity ratios

The following table shows activity ratios of MacDonald's. McDonald's is unquestionably the largest and most successful fast food restaurant in the world. Let's compare it to Yum!. Then we will find the differences between them and analyze whether Yum! Company has used its assets efficiently.

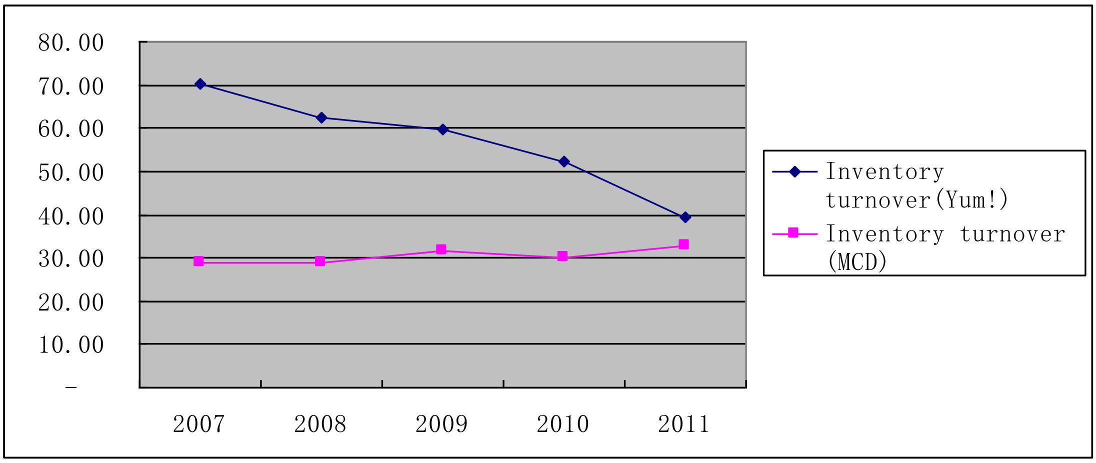
Table 4.20 Activity ratios of MacDonald.

Year	2007	2008	2009	2010	2011
Inventory turnover	28.91	28.83	31.58	30.22	32.73
Receivables turnover	6.12	5.93	5.71	5.37	5.37
Total assets turnover	0.78	0.83	0.75	0.75	0.82

Source: Annual Report (2007 to 2011) Author

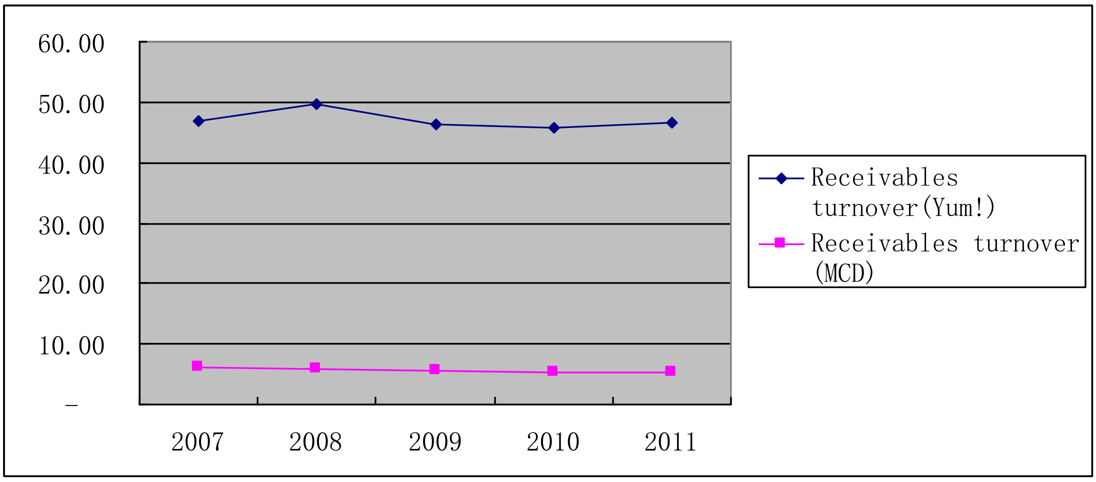
Firstly, we compare inventory turnover. The following is a curve graph to make sure that we can clearly see their differences. As can be seen from the chart 4.8 , the two curves show the fluctuation of inventory turnover from 2007 to 2011. During this period, the inventory turnover of MacDonald remained steady around 30. It means McDonald had an inventory turn rate of 30. This indicates that every 12 days, McDonald can goes through its entire inventory. We can see that Yum! has a higher turn rate.

Chart 4.8 Comparison of inventory turnover



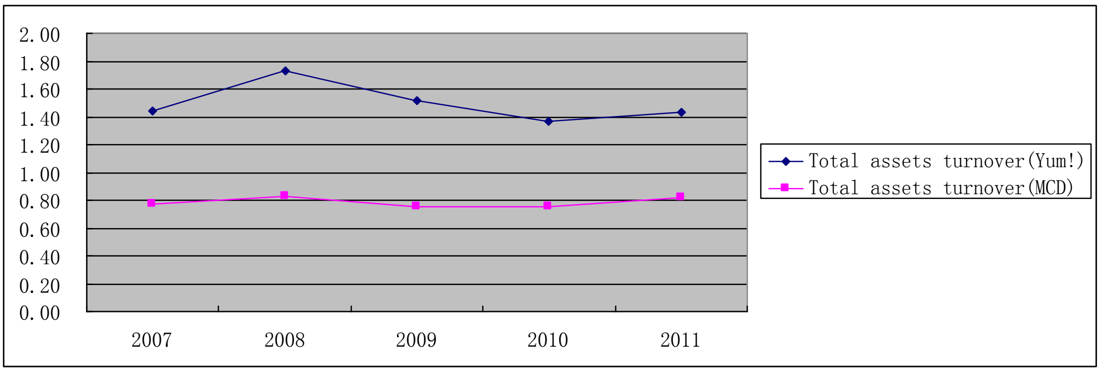
Until 2011, their difference between the two lines in the chart 4.8 become much smaller. This difference can make a great impact. By tying up as little capital as possible in inventory, McDonald's can use the cash in hand to do more investments. It eases the strain on cash flow considerably, allowing management much more flexibility in planning for the long term.

Chart 4.9 Comparison of receivables turnover



As shown in chart 4.9, receivables turnover of Yum! is much higher than MCD. But both companies receivables turnover is stable.

Chart 4.10 Comparison of total assets turnover



It is apparent that all the activity ratios are higher than MacDonald's according to the chart 4.8, chart 4.9 and chart 4.10. The data lead to the conclusion that the assets of MacDonald is used more efficiently. Assets efficiency utilization will have direct impact on liquidity. And one more thing should be point out is that the gap of this two company is becoming smaller. After all MacDonald is the largest fast food chain, Yum! is improving and try to be the best one from the trend of the blue line in the three chart.

4.2.4 Profitability ratios

Each company wants to make enough profit. Profitability ratios are very important indicators of the ability to make a profit of a company. Some data are presented below to calculate profitability ratios. These ratios can measure the ability of a company to make a profit. Investors usually use this ratio to evaluate whether a company is a potential one.

Table 4.21 Data for profitability ratios

Year	2007	2008	2009	2010	2011
Gross profit	1,357	1,517	1,590	1,769	1,815
Total revenues	10,435	11,304	10,836	11,343	12,626
Net profit	909	964	1071	1158	1319
Total Assets	7242	6527	7148	8316	8834
Total Equity	1,139	-94	1,114	1,669	1,916

Margins

We can use data above to calculate operating profit margin and net profit margin.

Table 4.22 Margins of Yum!

Year	2007	2008	2009	2010	2011
Gross profit margin	13.00%	13.42%	14.67%	15.60%	14.38%
Net profit margin	8.71%	8.53%	9.88%	10.21%	10.45%

According to the table 4.22, it shows the general trend that gross profit margin and net profit margin is growing up over time. It is a good trend for the company. It indicates the ability of the company to make a profit is stronger and stronger. Besides, we can find the net profit margin of 2008 is the lowest one of these five years. It is not difficult to estimate the reason that financial crisis happened in 2008. What to our surprise is that net profit is just a little bit lower than the level of 2007. It provides a strongly support for Yum! is stable enough to overcome the crisis. After 2008, the net profit margin has increased over 15% compared with the level of 2008. It is enough to see Yum!'s ability to make a profit. We can also see that gross profit is a little bit lower than the prior year, but net profit is still increasing. Because Yum! has paid lower interest and income tax in 2011. Yum! has less loans from bank, so the net profit margin is still going up. In the following, two graphs about margins are made to compare MacDonald with Yum!

Chart 4.11 Comparison of gross profit

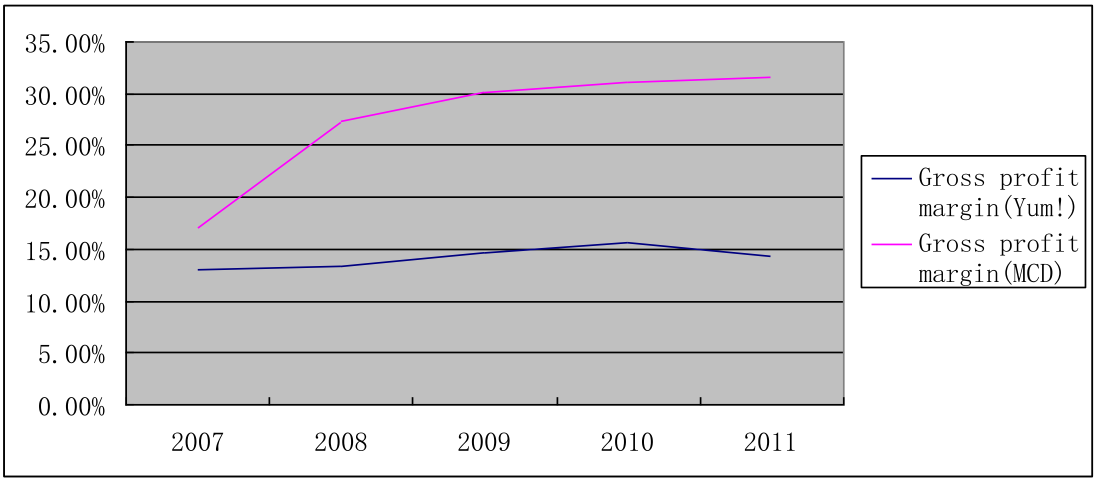
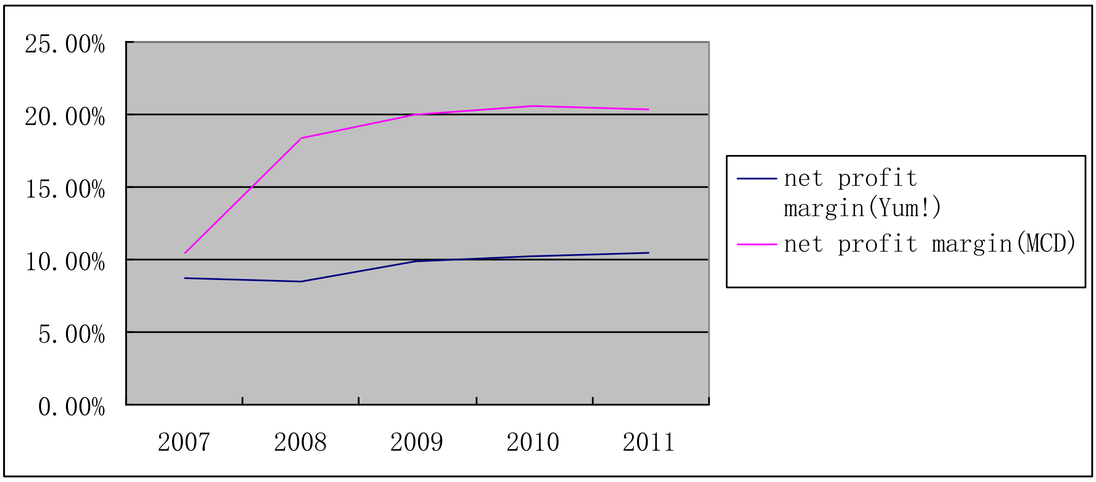


Chart 4.11 shows the gross profit margin of two companies. It is apparent that the overall level of MacDonald is higher than Yum! Company. The revenues of MacDonald is about two times of Yum! in the chart 4.11[13]. So we can know that the gross profit of MCD[14] is more than two times of Yum!. From this aspect, we can say MacDonald is operating well and make more profit than Yum!. Probably because it has more stores over the world. But recent years Yum! has expanded quickly, it has been Chinese biggest fast food chain. It is trying to "be the defining global company that feeds the world"[15]. The theme of their 2012 meeting[16] was "On the Ground Floor of Global Growth: China and a Whole Lot More." It seems that Yum! is working on expanding their scale over the world not only focus on the Asia market.

[13] The information is based on the income statement of MacDonald's, which can be found in the annual report(2007-2011).
[14] MCD represent MacDonald's.
[15] The sentence has been mentioned in the 2012 annual report, it is one of their strategy in 2012.
[16] Every year in December they host their Investor and Analyst Day in New York.

Chart 4.12 Comparison of net profit margin



This chart is similar to chart 4.11. So they have little differences in interest paid and tax paid. Probably their capital structure is similar.

Return on assets

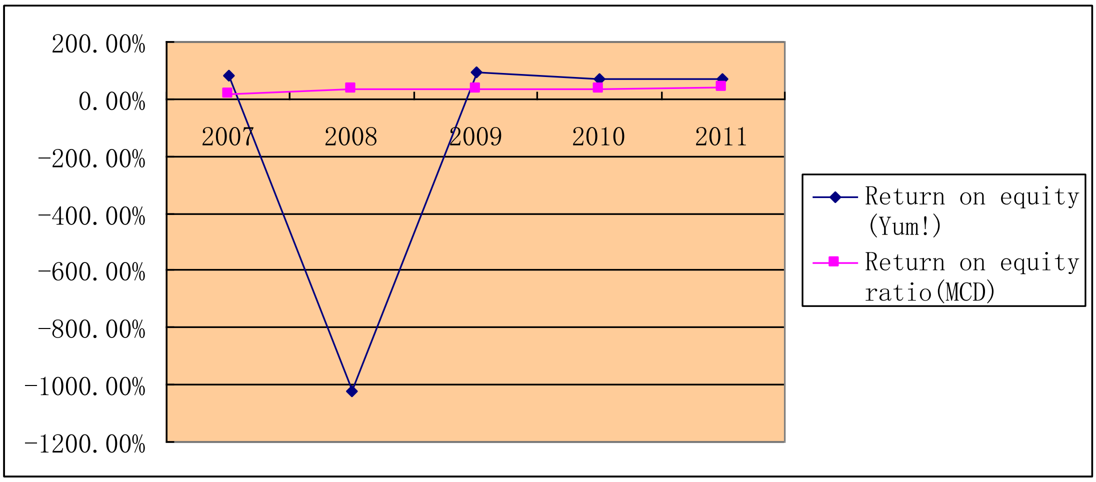
Table 4.23 Return on assets

Year	2007	2008	2009	2010	2011
Return on assets (Yum!)	12.55%	14.77%	14.98%	13.92%	14.93%
Return on assets ratio (MCD)	8.15%	15.15%	15.06%	15.48%	16.68%

The table 4.23 shows ROA of Yum! Company is slightly fluctuating. At first, it is increasing from 2007 to 2009 then it goes down from 2009 to 2010, finally goes up in 2011, all the ROA ratios are around 13% to 15%, which indicates the lever of the ability to invert investment into profit is relatively constant. On the other hand, it has a noticeable trend for MacDonald to increase over time. Apparently, MacDonald is able to make more profit which generates from shareholders' investment.

Return on equity

Chart 4.13 Return on equity



As is shown from chart 4.13, we can easily see that the blue line has a valley point in 2008. It is very abnormal. From the balance sheet[17] of Yum! in 2008, the equity is negative. So the return on equity is negative, too. Although financial crisis in 2008 has a great impact on many companies. Some of them even went to bankrupt. And Yum! is affected by some degree. Backing to the chart 4.13, return on equity of MacDonald is still stable above zero point. It indicates that MacDonald has better tolerance to the crisis. We can estimate it has good dividend policy to make sure ROE remained stable.

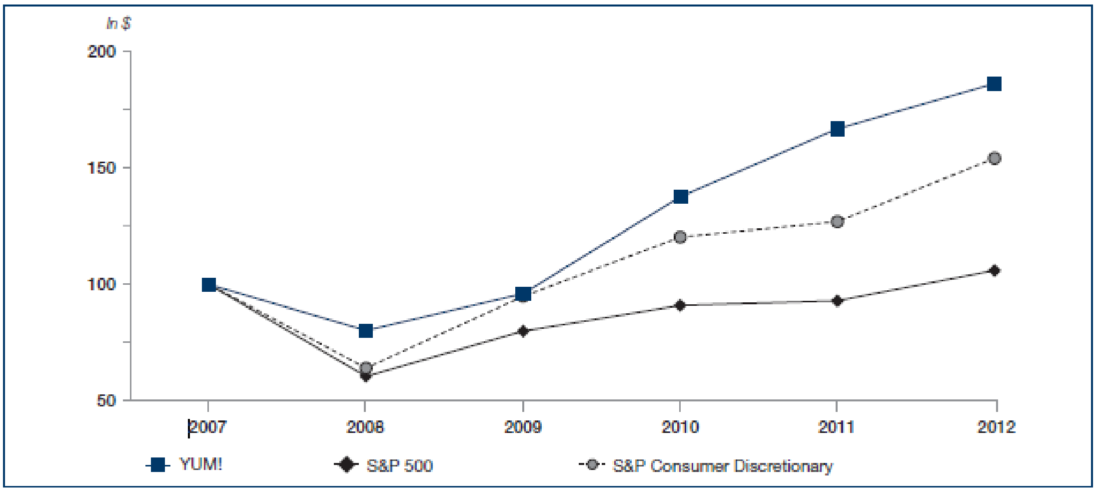
4.2.5 Market ratios

Yum! is a listed company. Many investors has bought this stock and get dividend. If it is worthy for investing is based on market ratios. Firstly, stock performance graph in recent five years is shown below[18]. Then some basic market ratios will be introduced in turns.

The graph below compares the cumulative total return of Yum!'s Common Stock to the cumulative total return of the S&P 500 Stock Index and the S&P 500 Consumer Discretionary Sector. The graph assumes that the value of the investment in the Common Stock and each index was $100 at December 28, 2007 and that all dividends were reinvested. As seen from the graph, the price of Yum!'s stock is growing up quickly even more than S&P 500. It indicates Yum!'s stock perform very well.

[17] Balance sheet can be found in the annexes.
[18] This graph is from annual report, 2012, page 105.

Graph 4.1 Comparison of common stock



	12/28/2007	12/26/2008	12/24/2009	12/23/2010	12/30/2011	12/28/2012
YUM!	$ 100	$ 79	$ 92	$ 129	$ 153	$ 168
S&P 500	$ 100	$ 59	$ 76	$ 85	$ 85	$ 95
S&P Consumer Discretionary	$ 100	$ 63	$ 91	$ 114	$ 119	$ 142

Earning per share (EPS)

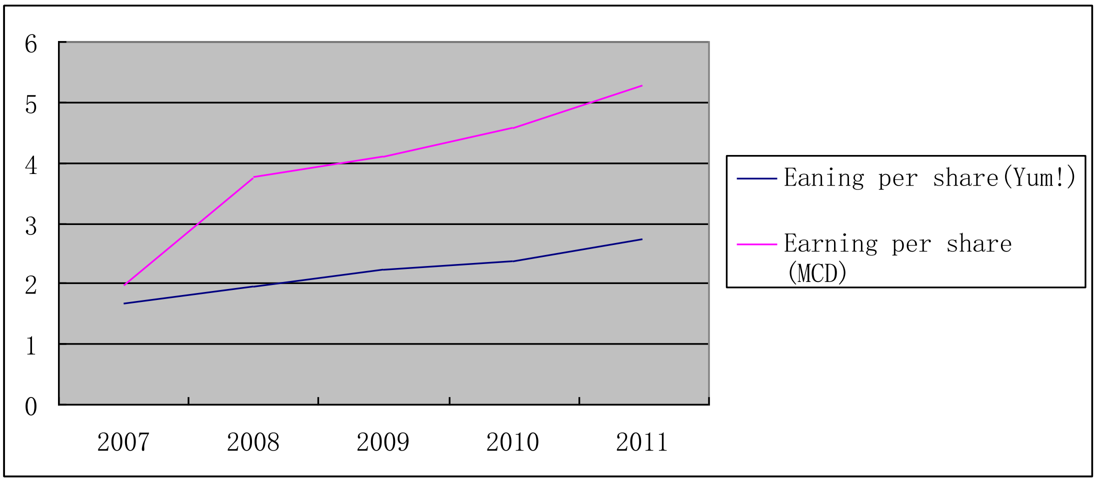
It can be used to value the equity investment. Investors usually pay attention to EPS because it can show the profit from each unit of equity. The ratio can be an indicator for analyzing the company's performance.

Table 4.24 Earning per share of MCD and Yum!

Year	2007	2008	2009	2010	2011
Earning per share (Yum!)	1.68	1.96	2.22	2.38	2.74
Earning per share (MCD)	1.98	3.78	4.11	4.58	5.27

It is clear from chart 4.14 that the EPS of MacDonald is more valuable. The slope of pink line is always bigger than the blue line. It means that the growth rate of EPS is higher. The stock of MacDonald is more valuable in this case. The mainly reason of it is the net profit of MacDonald is much more than Yum!'s. And the EPS of Yum! is stable which the slope is generally the same. It is not good for improving shareholders' confidence.

Chart 4.14 Comparison of EPS



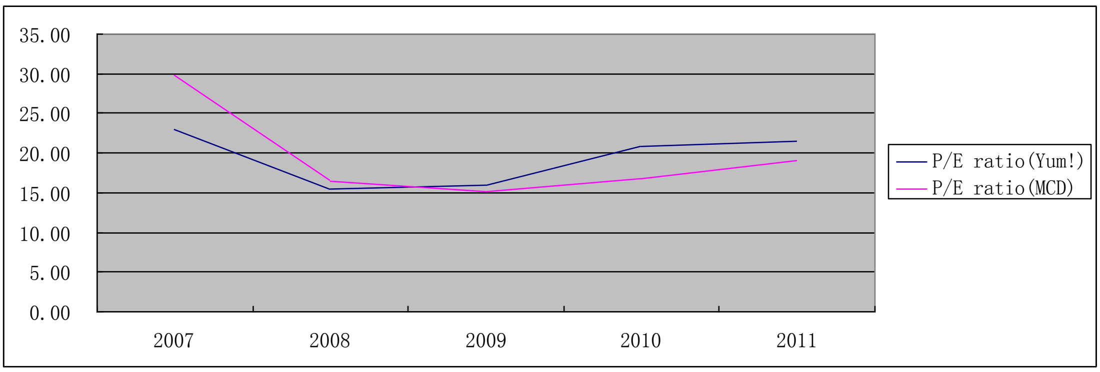
Price-to- earnings ratio (P/E)

Table 4.25 Market price of MacDonald and Yum!

Year	2007	2008	2009	2010	2011
Market price at year end (Yum!)	38.54	30.28	35.38	49.66	59.01
Market price at year end (MCD)	58.91	62.19	62.44	76.76	100.33

According to table 4.25, we can see the stock price of MacDonald is going up over time. Yum!'s stock price is increasing over time except 2008. In 2008, the broad stock market was going down rapidly. It has no exception to Yum!. On the other hand, the stock price of MCD remained growing steady. That is a rare case for most companies. This case provides that MacDonald has goodwill and the shareholders have more confidence with the company.

Chart 4.15 Comparison of P/E ratios



From chart 4.15, it is can be seen P/E ratio in 2007 is relative higher. Then both P/E ratios is declining in 2008. We can estimate P/E ratio of Yum! in 2007 is overvalued. When financial crisis occur, the stock price bubble was broken. The price would rapidly decrease. After 2008, the difference between the two stocks is smaller and Yum!'s stock price is a little bit higher than MacDonald's. In general, when P/E ratio is between 0 to 13, the stock is undervalued. When it is between 14 to 20, it's in normal case. When it is between 21 to 28, the stock is overvalued. When it is over 28, it probably is stock bubble[19]. So the stock price of Yum! in 2011 is likely to be overvalued

.

Dividend payout ratio

Table 4.26 Dividend payout ratio

Year	2007	2008	2009	2010	2011
Dividend payout ratio(Yum!)	30.03%	33.40%	33.80%	35.58%	36.47%
Dividend payout ratio(MCD)	73.73%	42.27%	49.11%	48.66%	47.43%

As we can see in table 4.26, each of MCD's dividend payout ratio is higher than Yum!'s. It is apparent that MacDonald is more valuable.

Chart 4.16 Comparison of dividend payout ratio

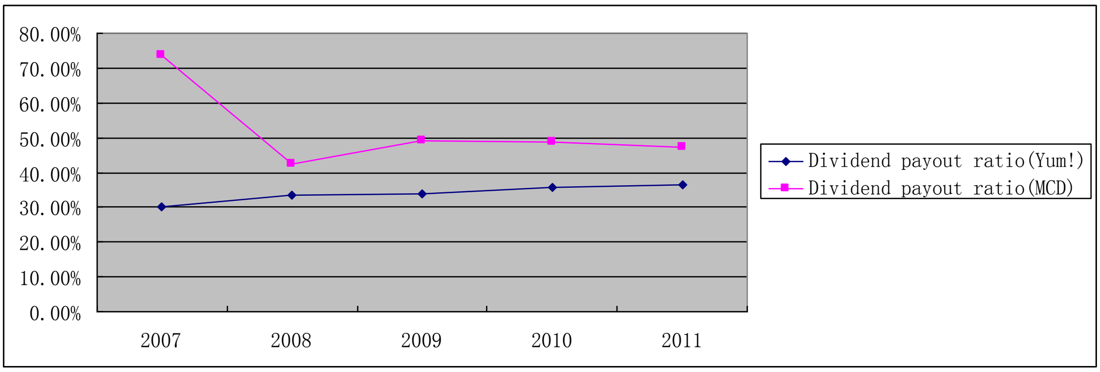


Chart 4.16 has shown that dividend payout ratio of MCD in 2007 is much higher than other years. In order to trace the reason, the profit in 2007 is found much lower than other years[20]

[19] The information can be founded in the following Chinese website: http://www.douban.com/group/topic/2880658/
[20] The information is from income statement of MacDonald in 2007.

and dividend paid has no big difference. So the result is relatively higher. Therefore, we can aware of MacDonald's dividend policy which is good for shareholders. Because the dividend is stable. Although payout ratio is declining in 2008, the ratio is still higher than Yum!'s.

4.3 DuPont analysis

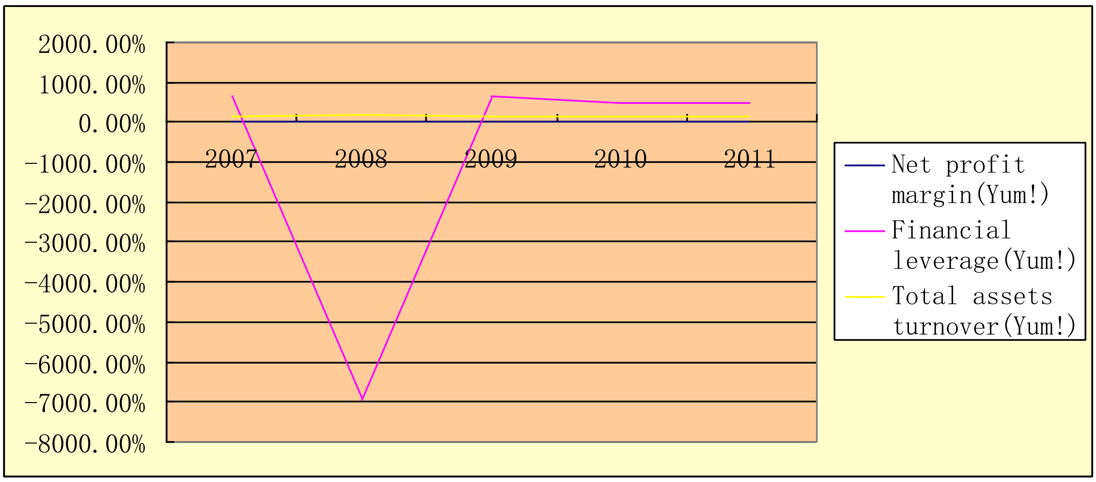
DuPont analysis is used for decomposing ROE into three components. They are respectively net profit margin, assets turnover and financial leverage.

Table 4.27 DuPont analysis

Year	2007	2008	2009	2010	2011
Net Income	909	964	1071	1158	1319
Total revenues	10,435	11,304	10,836	11,343	12,626
Total Assets	7242	6527	7148	8316	8834
Total Equity	1,139	-94	1,114	1,669	1,916
Net profit margin	8.71%	8.53%	9.88%	10.21%	10.45%
Total assets turnover	1.44	1.73	1.52	1.36	1.43
Financial leverage	6.36	-69.44	6.42	4.98	4.61
Return on equity	79.81%	-1025.53%	96.14%	69.38%	68.84%

As is shown in table 4.27, we can find the most important ratio which caused changes of ROE is financial leverage ratio. It has big impact on ROE. On the opposite, the least import ratio is net profit margin.

Chart 4.17 Decomposition of ROE



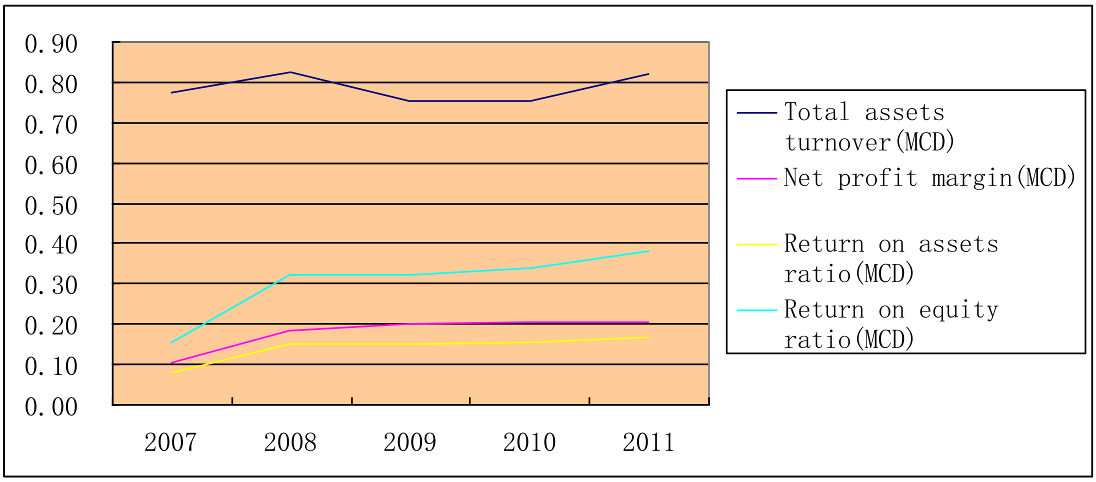
From the chart 4.17, the blue line of net profit margin is hardly to be seen. It is close to a horizon. It is stable. Backing to the chart 4.13, the line of ROE of Yum! is very similar to the financial leverage in this chart. So the company should control financial leverage to ensure the stability of return on equity. And companies should focus on capital structure and try to find optimal structure for capital. In this way, the company can get higher return and control financial risk.

Table 4.28 DuPont analysis of MCD

Year	2007	2008	2009	2010	2011
Net profit margin (MCD)	10.51%	18.34%	20.01%	20.55%	20.38%
Total assets turnover (MCD)	0.78	0.83	0.75	0.75	0.82
Financial leverage ratio (MCD)	1.92	2.13	2.15	2.18	2.29
Return on equity ratio (MCD)	15.67%	32.23%	32.43%	33.81%	38.24%

As can be seen in table 4.28, ROE of MCD is increasing gradually. In order to see which component ratio has great impact on ROE, a graph is presented below. It shows the changes of every component ratio during recent five years.

Chart 4.18 Decomposition of ROE of MacDonald



From chart 4.18, it can be found that each component ratio of MCD is moving stably. ROE is growing up over time. We have to say MacDonald has better capital structure and can control the resources which is exceed its equity efficiently.

4.4 Gradual changes analysis

Using this method, we can analyze which component is affect ROE the most.

At first, we calculate the absolute change of each component ratio between two years. Then we use the formula 2.24 to calculate the change of each component ratio.

Table 4.19 Gradual change from 2007 to 2008

	a_{2007}	a_{2008}	Δa	Δx_{ai}	order
$a_1 = EAT/Rev$	8.71%	8.53%	-0.18%	-0.0165	3
$a_2 = Rev/Assets$	1.44	1.73	0.29	0.157	2
$a_3 = Assets/Equity$	6.36	-69.44	-75.8	-11.19	1

$$\Delta ROE_{a_1} = -0.18\% \times 1.44 \times 6.36 = -0.0165$$

$$\Delta ROE_{a_2} = 8.53\% \times 0.29 \times 6.36 = 0.157$$

$$\Delta ROE_{a_3} = 8.53\% \times 1.73 \times (-75.8) = -11.19$$

From the table 4.19, we can see the change of each component more clear. Then the gradual changes of the following years are calculated below.

Table 4.20 Gradual change from 2008 to 2009

	a_{2008}	a_{2009}	Δa	Δx_{ai}	order
$a_1 = EAT/Rev$	8.53%	9.88%	1.35%	-1.62	2
$a_2 = Rev/Assets$	1.73	1.52	-0.21	1.44	3
$a_3 = Assets/Equity$	-69.44	6.42	75.86	11.39	1

Table 4.21 Gradual change from 2009 to 2010

	a_{2009}	a_{2010}	Δa	Δx_{ai}	order
$a_1 = EAT/Rev$	9.88%	10.21%	0.33%	0.03	3
$a_2 = Rev/Assets$	1.52	1.36	-0.16	-0.105	2
$a_3 = Assets/Equity$	6.42	4.98	-1.44	-0.2	1

Table 4.22 Gradual change from 2010 to 2011

	a_{2010}	a_{2011}	Δa	Δx_{ai}	order
$a_1 = EAT/Rev$	10.21%	10.45%	0.24%	0.016	3
$a_2 = Rev/Assets$	1.36	1.43	0.07	0.036	2
$a_3 = Assets/Equity$	4.98	4.61	-0.37	-0.055	1

The order means the degree of change, 1 is representing the component ratio has the deepest impact on ROE. As is shown in these four charts, it is apparent that the change of financial leverage is the biggest. The second one is assets turnover. Net profit margin has a little impact on ROE. But this situation excludes 2008. Because the change of assets turnover is the smallest one from 2008 to 2009. In this year, net profit is increasing. So the change of net profit margin becomes bigger. It is probably economy is recovering from 2009 after crisis. It is a very good trend for the company. At the same time, it gives investors confidence to believe that the company is full of potential. In a world, companies should control financial risk and focus on the financial ratios in order to adjust the structure inside the company in time.

5 Conclusion

Yum! Brand, Inc is a United States-based Fortune 500 corporation. It is one of the world's largest chain of fast food restaurants. There are three main famous Company of Yum!. They are KFC, Pizza Hut and Taco Bell. They provide various delicious food for customers. This thesis is focused on the financial analysis of Yum! Company. There are five parts in this thesis. The first part is introduction, then the second part some methods and their usages are described, the third part is an overview of the company, the fourth part is the most important part which analyzes the company in different aspects. When analyzing the company's financial position, the attention was paid to the analysis of trends of liquidity, profitability, activity and so on.

When different methods are used to analyze this company, it indicates that not all the ratios are ideal from 2007 to 2011. Firstly, based on results, the capital structure is not optimal for the company. Because when financial crisis occur, Yum! has more debt to pay back. In the same situation, data has shown that MacDonald can deal with it better. Yum! should cut down the percentage of debt. Secondly, when in the process of analyzing financial ratios, it is evident that its main competitor MacDonald's is doing better. Some of Yum!'s financial ratios are even worse than industry average. In this case, Yum! should pay attention to the weakness, such as high level of debt, lower liquidity and less efficient assets utilization. All of these problems should be improved. They should make measures to improve dividend policy and perfect assets utilization.

Besides, some results are good, such as the net profit of the company is increasing over time. Although financial crisis happened in 2008, Yum! recovered quickly because of its growth rate of net profit margin is higher.

In recent years, Yum! has been the biggest fast food chain in China. It is still expanding their scale. They are working on taking more shares in other markets of the world. "China and a whole lot more" is their slogan. In 2012, they set a new record for international development by opening nearly 2,000 new restaurants. They also grew worldwide system sales 5% and operating profit 12%. We can believe that they will be stronger in the near future.

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List of Abbreviations

ROA	Return on assets
ROE	Return on equity
EBIT	Earnings before interest and taxes
EAT	Eatings after taxes
Rev	Revenues
P/E	Price-to-earning ratio
MCD	MacDonald

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List of Annexes

Annex 1 Balance sheet of from 2007 to 2011 ($ Million)

	2007	2008	2009	2010	2011
ASSETS					
Current Assets					
Cash and cash equivalents	789	216	353	1,426	1,198
Accounts and notes receivable, net	225	229	239	256	286
Inventories	128	143	122	189	273
Prepaid expenses and other current assets	142	172	314	269	338
Deferred income taxes	125	81	81	61	112
Advertising cooperative assets, restricted	72	110	99	112	114
Total Current Assets	1,481	951	1,208	2,313	2,321
Property, plant and equipment, net	3,849	3,710	3,899	3,830	4,042
Goodwill	672	605	640	659	681
Intangible assets, net	333	335	462	475	299
Investments in unconsolidated affiliates	153	65	144	154	167
Restricted cash	0	0	0	0	300
Other assets	464	561	544	519	475
Deferred income taxes	290	300	251	366	549
Total Assets	7,242	6,527	7,148	8,316	8,834
Liabilities and Shareholders'Equity					
Current Liabilities					
Accounts payable and other current liabilities	1,650	1,473	1,413	1,602	1,874

Income taxes payable	52	114	82	61	142
Short-term borrowings	288	25	59	673	320
Advertising cooperative liabilities	72	110	99	112	114
Total Current Liabilities	2,062	1,722	1,653	2,448	2,450
Long-term debt	2,924	3,564	3,207	2,915	2,997
Other liabilities and deferred credits	1,117	1,335	1,174	1,284	1,471
Total Liabilities	6,103	6,621	6,034	6,647	6,918
Common Stock, no par value, 750 shares authorized; 460 shares and 469 shares issued	0	7	253	86	18
Retained earnings	1,119	303	996	1,717	2,052
Accumulated other comprehensive loss(income)	20	-418	-224	-227	-247
Total Shareholders' Equity – YUM! Company, Inc.	1139	-108	1,025	1,576	1,823
Noncontrolling interests	0	14	89	93	93
Total Shareholders' Equity	1,139	-94	1,114	1,669	1,916
Total Liabilities and Shareholders' Equity	7,242	6,527	7,148	8,316	8,834

Annex 2 Income statement of Yum! from 2007 to 2011 ($ Million)

	2007	2008	2009	2010	2011
Revenues					
Company sales	9,100	9,843	9,413	9,783	10,893
Franchise and license fees and income	1,335	1,461	1,423	1,560	1,733
Total revenues	10,435	11,304	10,836	11,343	12,626
Costs and Expenses, Net					
Company restaurants					
Food and paper	2,824	3,239	3,003	3,091	3,633
Payroll and employee benefits	2,305	2,370	2,154	2,172	2,418
Occupancy and other operating expenses	2,644	2,856	2,777	2,857	3,089
Company restaurant expenses	7,773	8,465	7,934	8,120	9,140
General and administrative expenses	1,293	1,342	1,221	1,277	1,372
Franchise and license expenses	59	99	118	110	145
Closures and impairment (income) expenses	35	43	103	47	135
Refranchising (gain) loss	-11	-5	-26	63	72
Other (income) expense	-71	-157	-104	-43	-53
Total costs and expenses, net	9,078	9,787	9,246	9,574	10,811
Operating Profit	1,357	1,517	1,590	1,769	1,815
Interest expense, net	166	226	194	175	156
Income Before Income Taxes	1,191	1,291	1,396	1,594	1,659
Income tax provision	282	319	313	416	324

Net Income – including noncontrolling interest	909	972	1,083	1,178	1,335
Net Income – noncontrolling interest	0	8	12	20	16
Net Income – YUM! Company, Inc.	909	964	1,071	1,158	1,319
Basic Earnings Per Common Share	1.74	2.03	2.28	2.44	2.81
Diluted Earnings Per Common Share	1.68	1.96	2.22	2.38	2.74
Dividends Declared Per Common Share	0.45	0.72	0.80	0.92	1.07

Annex 3 Cash flow of Yum! from 2007 to 2011 ($ Million)

	2007	2008	2009	2010	2011
Cash Flows – Operating Activities					
Net Income – including noncontrolling interest	909	972	1,083	1,178	1,335
Depreciation and amortization	542	556	580	589	628
Closures and impairment (income) expenses	35	43	103	47	135
Refranchising (gain) loss	-11	-5	-26	63	72
Contributions to defined benefit pension plans	-8	-66	-280	-52	-63
Gain upon consolidation of a former unconsolidated affiliate in China	0	0	-68	0	0
Deferred income taxes	-41	1	72	-110	-137
Equity income from investments in unconsolidated affiliates	-51	-41	-36	-42	-47
Distributions of income received from unconsolidated affiliates	40	41	31	34	39
Excess tax benefit from share-based compensation	-74	-44	-59	-69	-66
Share-based compensation expense	61	59	56	47	59
Changes in accounts and notes receivable	-4	-6	3	-12	-39
Changes in inventories	-31	-8	27	-68	-75
Changes in prepaid expenses and other current assets	-6	4	-7	61	-25
Changes in accounts payable and other current liabilities	102	18	-62	61	144
Changes in income taxes payable	70	39	-95	104	109

Other, net	18	58	82	137	101
Net Cash Provided by Operating Activities	1551	1521	1,404	1,968	2,170
Cash Flows – Investing Activities					
Capital spending	-726	-935	-797	-796	-940
Proceeds from refranchising of restaurants	117	266	194	265	246
Acquisitions and investments	124	-35	-139	-62	-81
Sales of property, plant and equipment	56	72	34	33	30
Increase in restricted cash	0	0	0	0	-300
Other, net	13	-9	-19	-19	39
Net Cash Used in Investing Activities	-416	-641	-727	-579	-1,006
Cash Flows – Financing Activities					
Proceeds from long-term debt	1195	375	499	350	404
Repayments of long-term debt	-24	-268	-528	-29	-666
Revolving credit facilities, three months or less, net	-149	279	-295	-5	0
Short-term borrowings by original maturity					
More than three months – proceeds	1	0	0	0	0
More than three months – payments	-184	0	0	0	0
Three months or less, net	-8	-11	-8	-3	0
Repurchase shares of Common Stock	-1410	-1628	0	-371	-752
Excess tax benefit from share-based compensation	74	44	59	69	66
Employee stock option proceeds	112	72	113	102	59
Dividends paid on Common Stock	-273	-322	-362	-412	-481
Other, net	-12	0	-20	-38	-43

Net Cash Used in Financing Activities	-678	-1459	-542	-337	-1,413
Effect of Exchange Rates on Cash and Cash Equivalents	13	-11	-15	21	21
Net Increase (Decrease) in Cash and Cash Equivalents	470	-590	120	1,073	-228
Change in Cash and Cash Equivalents due to consolidation of an entity in China	0	17	17	0	0
Cash and Cash Equivalents – Beginning of Year	319	789	216	353	1,426
Cash and Cash Equivalents – End of Year	789	216	353	1,426	1,198